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Specie in Banks.

Sam'l Hooper

1860



Lat 30 Dec. 1862

18





AN EXAMINATION  
OF  
THE THEORY AND THE EFFECT OF LAWS  
REGULATING  
THE AMOUNT OF SPECIE IN BANKS.  
BY  
SAMUEL HOOPER.

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## P R E F A C E .

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IN the following pages I have endeavored to show, that the "deposits," as well as the "circulation," of banks, are mainly created by the banks themselves; that bank-credits, in these two forms of "circulation," and "deposits," constitute the currency, or medium, for the transaction of the business of the United States; and that their security and permanency depend upon the possession by the banks of an adequate amount of specie to redeem them at all times and under all circumstances. I have endeavored also to trace or point out the origin of, and the causes that influence, the "exchanges" between different banks in large commercial cities, between different parts of the country, and between this country and other countries; in order to show, that a careful observation of these "exchanges" may—in connection with a law requiring the banks to hold a suitable amount of specie in proportion to their liabilities—provide a sound and stable currency for the country; and, as a practical illustration of this, I have referred to the condition of the banks of New Orleans under the operation of such a law in the State of Louisiana.

With a firm conviction that mistaken opinions and practices connected with the system of banking and currency prevail in the United States, and that these entail great dis-

advantages and losses on the enterprise and industry of the country, without benefit to the banks, I have endeavored to state the grounds of this conviction, for the purpose of submitting them to the consideration of others who are interested in the subject, and with the hope of thereby influencing the action of the States, which control the banking laws ; believing, as I do, that, in matters of legislation, "what is practicable is of as much importance as what is absolutely just and proper."

S. H.

Boston, December, 1859.

# CURRENCY,

BASED UPON

## AN ADEQUATE AMOUNT OF SPECIE.

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THE weekly reports of the Boston banks, for some time past, have exhibited a great decline in the amount of their specie, as compared with its amount in the corresponding period of the previous year. It appears, moreover, from the details of several of the recent reports, that some few of the banks disregard the law of 1858, which requires an amount of specie to be held by each bank equal to fifteen per cent. of its liabilities; for, although the aggregate of specie in all the Boston banks was more than twenty per cent. of their liabilities, some of them were "*out of line*," that is, had less than the required fifteen per cent.

In December, 1858, there was an aggregate amount of \$9,547,699 of specie in the Boston banks, against an aggregate liability for circulation and deposits of \$29,345,560, being more than double the amount of the fifteen per cent. in specie required by the law. The loans at the same time were \$58,510,123, and soon after were increased to \$60,319,965. The amount of specie was gradually diminished during the subsequent six

months; and it appeared from the weekly report dated July 18, 1859, that there was then only the sum of \$4,645,866 in specie against \$25,313,627 of deposits and circulation; being in the aggregate only about three and a half per cent. above the legal amount, while some banks had less than the law required. The specie was afterwards slowly increased by over eleven hundred thousand dollars; but since the end of October it has been again suffered to diminish; and according to the last return, dated December 12, there was then the sum of \$4,703,134 in specie against \$25,461,656 of liabilities, while the loans amounted to \$59,701,811.

It is to be regretted that any of the banks are disposed to keep so near the legal limits in regard to their specie, because it can be made obvious that a larger amount in the vaults of the banks is more profitable to their stockholders and more beneficial to the community, as it enables the banks to sustain a larger amount of loans, while it is also *safer* for the public and for the banks. Near the commencement of the present year the Boston banks had \$60,319,965 of loans, and held at the same time \$8,295,392 in specie; they were therefore rendering at that time more accommodation to merchants and others in the way of loans, and earning more interest for their stockholders, than in the following August, when their specie was reduced to \$4,667,352, and their loans to \$57,972,321.

It may seem paradoxical to state that banks can give greater facilities to the business community by having larger amounts loaned out, and hold at the same time larger amounts of specie in their vaults; but nevertheless it is true, as may be seen by the statement just

made ; and it is also consistent with the soundest theories and the soundest practices of banking. An examination and comparison of the published reports of the condition of the banks in different years will show, that their loans are usually highest when the amount of specie is large.

Commencing with the reports of the Boston banks during the year 1857, we find a weekly average amount of specie ranging, in the different weeks preceding the suspension of specie payments in that year, from \$4,083,622 on the 1st of June (being the highest amount during the year), down to \$2,370,887 on the 21st of September, three weeks before the suspension. Only two of the weekly reports during the year exhibited an amount of \$4,000,000 of specie, and there were eleven reports in which it was under \$3,000,000. The average of circulation and deposits during that time was about \$24,000,000, and of the loans about \$53,000,000. During the financial crisis the loans were rapidly reduced, and on the 19th of October were \$48,454,479; the deposits and circulation at the same time were reduced to \$18,847,341, with specie amounting to \$2,560,119. It is interesting to notice, that after the 21st of September the specie in the Boston banks began to increase,—slowly, it is true, but sufficiently to show that the exchanges with other places had turned in favor of Boston, and therefore that the immediate danger of a suspension of specie payments by the Boston banks had passed. But the suspension was forced upon them about three weeks later by the condition of banks in other cities. The specie continued to increase, notwithstanding the suspension of specie payments, until near the close of the year 1858, when



it amounted to over nine and a half millions of dollars, with about sixty millions of loans. Since then the amount of specie has unwisely been allowed to diminish, with but slight attempts to check its decrease, until, at one time during the year, there were only \$4,645,866 of specie and \$57,318,000 of loans. Probably both the loans and the liabilities of the banks must be decreased during the year 1860, if the banks intend to hold the amount of specie required by the law of 1858.

The published reports of the New York City banks for the past three years exhibit nearly the same relative condition, and about the same results, as the Boston banks, but on a larger scale.

The condition of the banks in New Orleans may be referred to as additional evidence, of another character, that banks are able, with a larger amount in specie, to furnish larger amounts of the "accommodations" they afford to the business community in the form of loans and discounts, and also to make greater profits for their stockholders.

Since the year 1842, the law of Louisiana, while placing no restraint on the investments of the capital of the banks of the State, has required that not exceeding *two thirds* of the funds derived from their deposits and circulation may be loaned, and this only for periods of not over ninety days, and on paper that is not to be renewed at maturity; while the remaining *one third* must be held by the bank in specie. Therefore, in the regular course of business in a bank of the State of Louisiana, a large amount daily becomes due and is paid into the bank from the two thirds invested in "short paper"; and this is available, if required, as well as the one

third in specie, to meet any demands against the bank. The banks in the State of Louisiana are required to publish reports, stating all loans upon real estate, and all other assets not payable within ninety days from their date, separately and distinctly, in a column by themselves; and this is denominated the "dead weight" of the bank. Their specie, and any assets or loans payable within ninety days from date, together with the cash liabilities of the bank, that is, their circulation and deposits, and any indebtedness payable on demand, are denominated the "movement" of the bank, and are stated under the proper separate heads.

One third of the liability of the banks to be held in specie, as required by the Louisiana law, is more than double the percentage required by the Massachusetts law of 1858. In addition, the law of Louisiana restricts the investment of the other two thirds of liabilities to paper having not over ninety days "to run," and not renewable; while the Massachusetts law does not restrict the length of time for the investments of the banks. This law of Louisiana has been in operation since 1842, certainly long enough to give it a fair trial. It carried their banks safely through the panic of 1857, without disturbing the currency of that State, and without distressing the customers of the banks; in fact, the financial panic of 1857 scarcely affected the monetary affairs of New Orleans, the great commercial metropolis of the Southwestern States.

Perhaps the best mode of testing the merits of the Louisiana law would be to examine the condition of the New Orleans banks and compare it with the condition of the banks in Boston, New York, and other commercial cities, where the laws are less stringent in regard

to the amount of specie in the banks, and leave the directors free to manage the investments according to their discretion. It is claimed by intelligent bankers and merchants, that this comparison with the Boston or New York (city) banks will show, that the New Orleans banks, with the percentage of their liabilities in specie nearly double, have a much larger loan in proportion to capital, and that their profits are nearly double. In other words, the New Orleans banks can by the same general course of business, and with double the amount of specie in their vaults, accommodate their customers, the merchants and others, with a larger amount of loans, and earn much larger profits for their stockholders, than the New York City or the Boston banks.

The following statement is condensed from the published reports of the banks of New Orleans for the 30th of April, 1859; being the only one at hand :\*

Capital stock	.	.	.	.	.	.	\$24,476,516
Loans and discounts, Short notes	.	.	.	.	.	19,926,493	
					Drafts and exchange papers	9,629,105	
					Long notes and other securities	20,835,332	
							50,390,930
Specie	.	.	.	.	.	.	15,572,505
Due to other banks	.	.	.	.	.	.	2,128,025
Deposits	.	.	.	.	.	.	21,664,892
Circulation	.	.	.	.	.	.	12,578,111

It will be perceived, that with a capital of \$24,476,516, the New Orleans banks have under discount and drawing interest, \$50,390,930, being over double the amount of their capital. The Boston banks, with \$35,162,600 of capital, according to the published reports of the same date, had under discount \$58,160,215, or about sixty-seven per cent. beyond their capital, and at the

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\* See Appendix A.

same time they held only \$6,726,647 in specie against \$15,572,505 in the New Orleans banks. The banks of the city of New York, with \$68,019,585 of capital, had then under discount \$128,706,705, and in specie \$26,329,805. The amount of the loans in the banks of New York and of Boston at this time was more than usual, and their amount is always increased by the practice of allowing interest on balances due to other banks and to public institutions. In many cases, also, the New York banks allow interest on the deposits of individuals that are expected to lie for any time in the banks. The New Orleans banks, instead of paying interest to others, have usually a very considerable amount in balances due from the New York banks, on which they receive interest, and which may be considered, in fact, as so much addition to their loans.

The regularity of the "bank movement" in New Orleans, secured and enforced, as it is, by an inflexible law in regard to the amount of specie, insures to each bank the confidence of the public, which enables all of them to use their available means to their whole extent, and to keep their loans at double the amount of their capital. In New York and Boston, on the contrary, without efficient laws to oblige the banks to keep an amount of specie that will insure the ability of each one of them to meet its engagements to the public, there must always be more or less distrust in regard to particular banks, that affects, and checks the efficiency of, all of them to some extent. In other words, the Louisiana system creates confidence, while that of New York and of the New England States cannot secure general confidence; for, although able management in most of the banks may prevent disasters from occurring in ordinary

times, the banks generally have not had resources immediately at command to resist the pressure upon them in times of financial trouble.

In regard to the profits of the New Orleans banks, since 1842, the "Bank of Louisiana" has paid ten per cent. per annum to its stockholders, and an extra dividend of five per cent. nearly every other year; and it has also accumulated a surplus of upwards of a million dollars. The "Canal Bank" has regularly paid dividends, of ten per cent., and has accumulated a large surplus. The "Louisiana State Bank" has for the last two years paid twelve per cent. per annum, and previously regular dividends of ten per cent., besides accumulating a surplus of over \$300,000. The "Citizens' Bank" in about five years has paid sixty-four per cent. in dividends, and reserved a million of dollars, which by law has since been constituted capital. The "Free Banks," as they are termed, that is, banks organized under a general law similar to the general or free banking laws of Massachusetts and of New York, are compelled to cover their circulation by the deposit of an equivalent amount of State securities, and also to keep specie to the extent of one third of their liabilities; consequently they have not been so profitable as the chartered banks, but they have paid dividends of eight to ten per cent., besides retaining a moderate surplus.

Any one familiar with the condition and the profits of the banks in Boston and in New York can judge, from the foregoing statement, whether the large amount of specie, which the law of Louisiana renders necessary to the banks in New Orleans, impairs their profits or their ability to accommodate the public.

If a bank was satisfied to loan only the amount of its capital, having neither circulation nor deposits, it would not be necessary to retain any specie in its vaults, as the only business of the bank would be to re-loan all money as fast as it was paid in. The capital would be the property of the stockholders, to be invested at the discretion of the directors. It would be simply a bank of discount, or a loan-office, constantly re-investing its receipts. The institutions established under the prevailing system of banking throughout this country are all banks of circulation and deposit, as well as of discount. Their circulation and deposits, which constitute the debt of the banks payable on demand, though constantly varying in amount in banks doing an extensive business, are not often reduced suddenly below a certain average ; and therefore a portion of the funds derived from these fluctuating sources can usually be loaned with safety. The great evil in this practice of banking, is the temptation to loan too large a proportion of this fluctuating fund derived from deposits and circulation, and upon too long a time, in the faith that they will continue in the bank without a demand for their payment. To guard against this temptation, the law of Massachusetts requires the banks to retain fifteen per cent. of such liabilities in specie, and permits the balance beyond the fifteen per cent. to be loaned at the discretion of the directors ; while the law of Louisiana requires the banks of that State to retain one third of such liabilities in specie, and permits the other two thirds to be loaned on time not exceeding ninety days. No one can doubt that the Louisiana law is the safer for the banks and for the public ; and if experience proves that it is also more profitable to the stockholders of the banks, and more

beneficial to the merchants and others who are the customers of the banks, it would seem to be the duty of legislators to make such the law in every State where banks exist.

A person ignorant of the mysteries of banking would naturally suppose that a bank with a fixed amount of capital, in proportion as it held a large amount of specie, would have less money to loan to its customers; and therefore that the amount of specie a bank is required to hold should be in proportion to its capital. But the amount of specie a bank holds is important only in reference to the amount of its liabilities which are due and payable on demand, that the bank may be in a position at all times to meet any demands which may be made for the payment of the circulation, of the deposits, and of the balances due to other banks. It is the proportion of these liabilities to the public, and not of the capital which belongs to the stockholders, that the law of Massachusetts, as well as the law of Louisiana, requires to be in specie.

A bank with a large amount of specie in proportion to its liabilities, which is always the condition of the New Orleans banks, is in a stronger condition, and more able to make loans, than a bank with less of liabilities, but with very much less of specie in proportion, which is the usual condition of the New York and Boston banks.

One of the apparent mysteries of banking, that is not generally understood, is, that the deposits and the circulation usually increase or diminish as the loans of the banks increase or diminish. The explanation of this mystery will be found in the fact, that the amount of deposits and circulation depends mainly on the amount

of the loans. The loans of a bank are made in the form of discounts, which are passed to the credit of the party for whom the discount is made, whereby it becomes also a corresponding amount of *deposit*; and when this deposit is drawn out of the bank, it is usually paid in the bills of the bank, and is thereby changed into *circulation*. The deposits and the circulation must therefore be considered together, inasmuch as the bank-check goes as far as the bank-note in making purchases and payments; both are liabilities of the banks payable on demand. The result of any discount made by a bank must always be to increase the "deposits" or the "circulation" to the same extent that it increases the "loan" of the bank.

Many bank managers will reply to the foregoing statement, that the whole amount of the discount or loan, so entered as a deposit to the credit of the party for whom it was made, may be drawn out of the bank *in specie* on the same or the next day; which may be true, particularly if the bank had before too much loan, or too great an amount of liabilities. If this should be done, the discount referred to will have increased the amount of deposits, in that particular bank, only for a single day. But if, when this amount is drawn out, it is paid into some other bank, it will serve to increase the deposits there, and so continue to swell the aggregate amount of deposits. But it is equally, and perhaps more true, that any loan or discount that is made by a bank may not,—at least for some time,—be drawn out of the bank in specie; but that the checks drawn against it may be in favor of, or paid to, a person who keeps an account at the same bank, in which case the amount is merely transferred from one account to another in the



same bank, and continues to be a deposit there; and that, when finally it is drawn out, it may be paid in the notes of the bank to be sent to a distance, and may circulate for months, or that it may come back to the bank in payment for some debt due to the bank, which is often the case. Therefore, until the deposit or circulation created by any discount is extinguished by being used to pay a debt to the banks, or by payment in specie or in some other form, the bank returns must continue to show for this increase of loan a corresponding increase of deposits or circulation. To restate the matter; if we consider the banks in Boston in the aggregate, or as a unit, any discount, made by any one of the banks, must serve to increase the aggregate of deposits or circulation to the same extent that it increases the aggregate of loans, until it is used to discharge a debt due to one of the banks, or has been paid in specie. Whether the discount will probably cause a demand for specie on the bank making it or not, will depend on the "*exchanges*" of the bank, which will be considered hereafter.

It is thus apparent that the deposits, as well as the circulation, are mainly created by the banks, and are not, as is generally supposed, money brought to the banks by various parties to be lodged there temporarily for safe keeping. It happens occasionally that an amount on deposit originates in money so brought to the bank and placed there for safety; but the great mass of deposits in the banks of the large commercial cities originates in discounts made by banks, and is therefore the creation of the banks. The deposits are loans of the credit of banks. In order that banks may have the ability to furnish "deposits" and "circulation"

to the merchants and others, their customers, for the accommodation of the trade and commerce of the community, it is important that they should hold an amount of specie sufficient to insure their ability to meet any demands upon them, and to inspire the public with confidence in their engagements; and the amount of specie required must be in proportion to the extent of the liabilities which they incur. The deposits and the circulation are mainly the result of their loans, and their specie is the basis on which their ability to loan depends. When the amount of specie in the banks is small, the loans and the liabilities for deposits and circulation should be so likewise. It is often said by the managers of banks, "Our deposits are so low we cannot discount;" but they mean to say, that their specie is so low. The fact of their deposits being reduced, should be an inducement to discount, if the amount of their specie has not been diminished. There seems to be always a peculiar unwillingness on the part of the managers of banks to make any reference to a low condition of their specie.

It is important to understand "the exchanges" of the banks, as it is through them that a bank is most affected. They indicate the strength of the bank, and the means it can immediately command. For the day, the ability to discount liberally depends on the result of the settlement each morning at the "Clearing House." It has been stated before, that the deposits and circulation, though constantly varying, are seldom reduced suddenly below a certain average. How far they will vary on any particular day, or how much they will be reduced and thus draw out specie from the bank, is

ascertained by the settlement at the Clearing House ; and the bank is rich or poor, for that day, according as the settlement is favorable or unfavorable.

If a bank, in consequence of new discounts or loans, is expanded more than usual, as compared with the surrounding banks with which it has to make frequent settlements, that is, if a bank has suddenly increased its loans beyond their usual amount, a balance that must be paid in specie will soon be created against it in the settlement with the neighboring banks. Whenever a bank suddenly enlarges its loans, this effect may be produced ; as the depositors of that bank will have an increased amount at their command, which they can draw out to be paid to others and to go into other banks, while they have no more of the notes of, or checks on, other banks, received in the course of their business for the day, to deposit there. If, however, the other banks, at the same time, enlarge their loans in the same proportion, the amount of demands received upon those other banks should also be increased in like proportion ; and, in that case, the balance to be paid in specie would not be affected by the increase of loans.

When all the banks of Boston enlarge their loans simultaneously, and in like proportions, the *amounts* due from one to another by the business of the day are enlarged, but not the *balances* due from one to another, because each bank has a correspondingly enlarged amount of claims upon the others as an offset. It is not intended to represent that these results follow with regularity on the action of the banks ; on the contrary, the results of the settlements at the Clearing House are often very irregular and unexpected ; still, there is a general uniformity of result, corre-

sponding to the action of the banks, that is often surprising, considering the uncertainty of the elements, in all their details, which produce it. The effect of the simultaneous enlargement of the loans of all the banks in one city, would be shown in the exchanges with other cities connected with it in trade, like Boston and New York. If the loans are enlarged in Boston, the exchanges with New York would be against Boston, as the banks in New York would collect, in various ways, larger amounts against the Boston banks, creating balances against them beyond what they could offset, which must be paid in specie. The exchanges would continue against Boston, and in favor of New York, and the demand for specie out of the Boston banks, to be sent to New York, would continue until the loans of the two cities were brought to their usual relative proportion; and this may be accomplished either by diminishing the loans of the Boston banks, or by enlarging those of the New York banks.

So it is also in regard to the banks generally throughout the country. If the banks of Boston, New York, and the other commercial cities, enlarge their loans simultaneously, and in about the same proportion, the amounts due from one city to another are enlarged, but not the balances. But this general enlargement of loans produces a general increase of deposits and circulation, making money plentiful, or "easy," and trade active, and thus causing a general improvement in prices, and consequently an increase of foreign imports. The circulating medium of the country is thus diluted, and, relatively to the circulating medium of other countries, is made weak and over-full; and this evil will continue unchecked, and go on increasing

until it has rendered the exchanges with other countries favorable to those countries and against the United States. *High prices of merchandise encourage the importation of foreign goods, and discourage the exportation of our own products.* The natural result of this process is to create balances against this country and in favor of other countries, that can only be paid in specie. The demand for coin to be exported which is thus created, will oblige the banks to diminish the amount of their loans until the circulating medium of the country, that is, the deposits and circulation of the banks, is restored to its usual relative proportion to the circulating medium of other countries.

For a better understanding of this subject, it may be well to consider the trade and commerce which underlie and produce the effects that are made apparent by the "exchanges." The object of all trade and commerce is mutual benefit by the interchange of products. This interchange is constantly occurring; often between different parts of the same country to a very great amount in the aggregate, made up of a great variety of transactions by many different persons, acting independently of each other. These various transactions offset each other to a great extent, and leave usually but small balances to be settled in money, like the settlements of the banks at the Clearing House. The aggregate of the amounts sent in from the different banks in the city of New York, during the week ending December 17th, 1859, against all the other banks, was \$130,260,563. This amount represented transactions settled during the week by the payment of money; but, the demands of each bank being offset by the demands against it from the other banks,

the amount of the balances actually due from them all was \$7,838,770, or about six per cent. of the amount of the demands; and these balances only must be paid in money. There is a like offset in the transactions of trade between different countries, or between different parts of the same country; and it is only the balances (which are but a small percentage of the amount of the transactions), that affect the "exchanges" between the different countries, or the different parts of the same country, and require to be settled by the transfer of specie. This being understood, it is easier to perceive how slight the causes may be that affect the "exchanges" between two places; as, for example, between Boston and New York, or between the United States and Great Britain. It requires no very great increase of bank loans in Boston, to render money "easier" or more plentiful there, and thereby to encourage an activity of business that will increase the disposition to send to New York for purchases, while it discourages the disposition to send articles there for sale. The difference of one per cent. in the price of an article of merchandise may, in many cases, decide a purchaser between buying an article of his next door neighbor, or sending to New York for it. And so in the commerce between this country and Europe, a difference amounting to a small commission on the cost, may decide between an order being sent out for a purchase of English, or French, or German goods, and the purchase of the same article of domestic manufacture; or it may decide the foreign manufacturer between taking the chance of the shipment of his goods to this country, and selling them at home. No one who is in the habit of noticing the action of the

banks can doubt, that the increase or the decrease of the loans of the banks for a few successive weeks, to the extent of only a few millions, does affect the activity of business and the price of merchandise and of stocks, often to a very considerable extent; and it is this effect that influences the "exchanges" between different places and different countries.

To reduce the amount of the loans of the banks is the simple remedy for the temporary derangements of the currency which are constantly occurring, and which are inseparable from commercial transactions on a large scale. The diminished amount of the specie in the banks would always render this a self-applying remedy, if the law absolutely obliged banks to hold a certain proportion of specie as a condition of their power to discount. In the absence of an absolute law, this remedy may be,—in fact, experience has shown that it is certain to be,—neglected, until the consequences of the neglect, in the instance of a single bank, force that bank to borrow aid from others. The stronger banks are obliged, for self-preservation under such circumstances, to furnish aid to sustain the weaker banks; for they could not probably themselves withstand, and dare not risk, the effects of the shock of public confidence, that would be produced by the inopportune failure of any one bank. But, if the neglect of this remedy has been general among the banks, they will all seek to be borrowers, with none able to lend, and a suspension of specie payment is thus rendered imminent, if not unavoidable.

Whether any increase of loan in any one bank, in Boston for instance, will cause a demand upon that bank for specie from those around it, will depend on

the relative condition of the bank, at the time, in regard to those other banks. The same principles and conditions would operate to create a demand for specie from that bank, which on the occurrence of a general enlargement of the loans of all the Boston banks, would operate to create a demand for specie in favor of New York, or a general demand for specie to export, on the occurrence of a general enlargement of bank-loans throughout the country.

There is usually no difficulty, particularly when it has not been too long delayed, for the Boston banks to check and to stop the continuance of a demand for specie from New York, or elsewhere; but there is only one way to do it, and that is, by a concert of action in reducing the amount of their loans. This concert of action would not require any special arrangement to be made at the time, but would result from the same cause acting simultaneously upon all the banks, and operating on each one of them with a force proportioned to the extent of its expansion as compared with the other banks, whenever the uniform requirements of law, and not the varying judgment of each board of managers, shall regulate the minimum amount of specie that shall be necessary in a bank. The effect of a law absolutely requiring a proportion of the liabilities to be held in specie as a condition for discounting, is to keep each bank up to a certain degree or standard of ability.

In January, 1859, when the aggregate of specie in the Boston banks was rapidly diminishing in consequence of the demand for coin from New York, the banks reduced the amount of their loans sufficiently to check the *rapidity* of the drain of specie, but still permitted



this drain to proceed slowly until the following April. After that time, until June, the specie increased to a small extent. The loans were then suddenly increased by about \$1,500,000 in the course of that month, which immediately caused a rapid decrease of specie, so that over \$2,000,000 in coin were lost to the banks; and, according to the returns in July, the amount of specie in the Boston banks was less than half of what it was at the beginning of the year. This drain of specie could have been easily stopped, and the amount in the bank-vaults could have been soon after restored to what it was at the beginning of the year, if the banks had persevered longer and uniformly in the curtailment of loans, which a part of them commenced. If all of them had done so, their aggregate amount of specie and their aggregate amount of loans might have been as large at the end of the year as at the commencement. There was very nearly, if not quite, sufficient specie in the Boston banks during a great part of the year 1858, and at the beginning of the next year, to meet the requirement of the law of Louisiana; and, if a similar law had been in operation to control the Boston banks, they would have been obliged to act in concert to reduce their loans, in order to turn the exchanges in their favor, and thus to retain their specie; and, in consequence, both their loans and their specie would now probably be as great in amount as they were in January last. The course of the banks in the city of New York was nearly as unwise through the year, as that of the Boston banks. They allowed the amount of their specie to diminish, and they are now relatively nearly as poor in specie. In July, 1858, they had \$35,712,107 of specie in their vaults, and their

loans at one time were over \$129,000,000. The latest weekly return, dated December 10th, 1859, exhibits \$19,750,535 in specie, and \$122,925,408 of loans.\*

It is equally easy for any one bank of a city to prevent its specie being drawn out, by reducing its loans whenever, in the daily settlement at the Clearing House, there is a balance against it to be paid in coin. But this reduction of loan must be continued until the balances at the daily settlements are in its favor. Then, and not till then, the bank may begin to discount again, but moderately at first. After its stock of coin is fully replenished, the extent of new discounts and the amount of loan should be regulated by the daily results of the Clearing House;—that is, when the balances, day after day, are favorable, so that each day specie is gained in the settlement, it is evident that the “exchanges” are in favor of the bank, and the discount line can therefore be enlarged with safety; but when the settlements are about even, that is, showing small balances each day, sometimes adverse and sometimes favorable, the discount line should be neither enlarged nor contracted, and the bank should only re-discount the portions of the loan that fall due each day. When the bank is losing specie day after day in the settlement, it is then evident that the “exchanges” are against the bank, and that the loan is too high, and must be diminished. These daily settlements at the

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\* *Extract from the reports of the weekly averages of the New York banks.*

1859.	Loans.	Specie.	Deposits.
January 22,	\$129,540,050	\$29,472,056	\$95,066,400
October 8,	117,211,627	19,493,144	69,501,207
Decrease,	\$12,328,423	\$9,978,912	\$25,565,193

Clearing House indicate the relative condition of each bank to those around it, as the state of exchanges between New York and Boston indicates the relative condition of the banks of those two cities, and as the rates for bills on London indicate the condition of the currency of this country in relation to that of Great Britain.

The amount of loans which can be relied upon usually by a bank to cause the balances in the daily settlements of the Clearing House to be moderate, so that its specie shall not be materially diminished or increased, is always changeable and uncertain, as it is influenced by various causes, many of them being often outside, and beyond the control, of the bank. A very favorable or a very unfavorable settlement will sometimes occur when it is least expected, from causes that could not have been foreseen in the bank. For instance, the exchanges with New York may be affected and turned against the Boston banks in consequence of a sudden curtailment of the loans of the New York banks, or by large payments to New York, or investments there for account of merchants or others in Boston, of which nothing was known in the Boston banks until it became obvious by its effect on the exchanges between the two cities; or it may be, that the exchanges have been suddenly turned against the United States by a stringent condition of the London money market, which calls for a prompt remittance of any balances in this country due to bankers and others in London, the first effect of which in this country would be felt in New York. And in this way, also, the balances at the settlement in the Clearing House may become unfavorable, or the reverse, to any one bank in Boston, in consequence of a curtailment or an enlargement of the loans of the

other banks. The proper amount of loans, therefore, must depend on the amount of specie in the bank; and the requisite amount of specie in the bank should always be an ample sum to meet any of the unforeseen contingencies that have been referred to, and to allow any unexpected demands against the bank to be met without inconvenience. The law of Massachusetts requires a bank to stop discounting, when its specie is reduced below fifteen per cent. of the liabilities of the bank, and the law of Louisiana, when it is reduced below one third. A prudent and judicious manager of a bank, in either of those States, would therefore consider the requisite amount of specie, under ordinary circumstances, to be so much above the amount required by the law, that any occasional and unexpected demand for specie could be met without interrupting the usual business of his bank. The life of banking business is to be constantly making fresh discounts, because the benefits, contributed by former discounts, of accommodation to the merchants and of increase to the deposits and circulation of the banks, are soon exhausted. These must be constantly sustained by frequent contributions of fresh discounts. To enable a bank to do this with safety, the discounts must be on short paper, and there must always be a liberal amount of specie in the bank. The extent of the ability of the bank will be in proportion to the amount of the specie in the bank-vaults.

If a bank should determine, as a general rule, to have not less than any certain specified amount or proportion of its liabilities at all times in specie,—whether it was one third or one tenth of the liabilities,—whenever the specie was “running down” and nearly reduced to that limit, the bank would stop discounting, until the

balances at the daily settlement were in its favor, and the coin in its vaults began to accumulate. In a bank where the managers were content with an amount of specie not exceeding one tenth of the liabilities, discounting would be stopped from necessity whenever there was an unfavorable settlement at the Clearing House, unless the business of the bank was such that any demand for specie could always be anticipated; for there would be danger almost any day, with so small a proportion of specie, that all of it might be drawn out, and the bank be unable to meet its engagements without aid from others. The most prudently managed banks may happen occasionally to be in this condition; but, in a bank, where it is often occurring, there is danger that it may, at some time, cause an outright failure. A bank managed in this manner, holds out but small inducements to those who keep accounts there, by the facilities it can promise them, because its discounts must be made at irregular and long intervals; and it would more often be in a condition to require aid from others, than to render facilities to any but its own directors. Such a bank is usually poor, its loan is small, and it generally relies more on the aid which it derives from its depositors, than the aid it can render to them by frequent and liberal discounts. On the other hand, a larger amount of specie may be kept in a bank with equal facility; the same action would be required in either case, whenever the balances in the settlement at the Clearing House were unfavorable. But a bank with the larger amount of specie would not be so much affected by occasional and unexpected balances against it, and would sooner recover from the effects of them, as it would usually have more ample means at command

to meet such contingencies without inconvenience. A bank managed in this manner is seldom strained to the extent of its ability, and therefore its customers feel confident of its aid in any common emergencies; it inspires confidence, and it encourages those who keep the best bank accounts to come there to avail themselves of the facilities it can grant. In a bank of this character, there is usually the largest amount of loan in proportion to capital, notwithstanding that it has always a larger amount of specie in its vaults in proportion to its liabilities. It is because the law of Louisiana compels each bank in that State to keep a sufficient amount of specie, that the banks of New Orleans are always in a stronger condition, and are more profitable to their stockholders, than the banks of New York or Boston.

It is often said by intelligent managers of banks, that they cannot afford to keep a large amount of specie in their bank-vaults, because it is unproductive there, and the bank loses the interest on it. But the truth is the reverse of this; it is the small amount of specie that they cannot afford to keep, because it renders their bank poor and unable to discount, and obliges them to call in their loans, and to watch with anxiety every settlement at the Clearing House, and to dread every demand upon them for coin. With a large amount of specie, they can sustain a large amount of loan; if the specie is diminished, the loan must be contracted. It cannot therefore be said that the banks are losing the interest on the amount of specie in their vaults; for the more they have of it, the more ability they will have to increase their loan. The banks in New Orleans are often receiving interest on more than double the

amount of their specie, after allowing for the interest on their capital. The specie is supplied to the banks by the public who are their depositors, or who are using the notes of the banks for circulation in place of it, with the express understanding that they may receive back their gold, in exchange for those notes and deposits, at any time when they may demand it. The banks are not required to keep any portion of their capital lying idle in specie in their vaults; they can loan all their capital; it is only a proportion of their liabilities for circulation and deposits that they are required to retain in specie. The question is, What proportion of the amount that a bank owes for its circulation and deposits shall be loaned out, and what proportion shall it be required to retain in coin to meet the demands for its liabilities? The law of Louisiana establishes one third, and the law of Massachusetts, fifteen per cent., as the proportion to be so retained by the banks in specie.

The operations of a single day, or of several days, in a bank may, and often do, produce effects apparently and really at variance with the theory and the results herein contended for. It is claimed, however, that these results may be relied upon when the banks have followed out and acted upon these theories for a sufficient time to influence and control the exchanges between different parts of the country, and between this and other countries. It has been stated before, that it is not intended to represent that the results will always conform at once to the action of the banks. The physician may prescribe to his patient a particular course of diet, as being essential to the restoration and preservation of his health; but it would usually be con-

sidered unreasonable for the patient to claim the promised result after a single day, or even week, of the strictest observance of the prescription.

The banks in Massachusetts are chartered with the condition that their capital shall be paid in specie, and commissioners are appointed to examine and to certify that this condition has been fulfilled, before the bank can commence business. The regular business of a bank, contemplated and sanctioned by law, is to loan its credit, but only on the condition of its being redeemable on demand in specie; and it is for this purpose that the capital is required to be paid in specie before the business is commenced. The laws of Massachusetts strictly forbid the banks to issue an obligation, in any form, to pay money at a future day. The mode of loaning the credit of a bank is by making discounts, the amounts of the discounts to be placed to the credit of the party for whom they are made, as "deposits," or to be paid to them in the notes of the bank, as "circulation." The amount of loan is limited by law to double the amount of the capital of a bank, and the amount of circulation is limited, in like manner, to the amount of the capital; but the law does not limit the amount of the deposits.

It has been contended by some, that the original intention of the law was to require a bank to have the amount of its capital in specie, for the purpose of meeting demands that may be made to redeem any portions of its liabilities for circulation and deposits; and that whenever, by paying out specie to redeem portions of these liabilities, the amount of specie was reduced below the amount of the capital, then the bank



must stop discounting until that deficiency was restored. This view of the intention of the law is very different from the existing practice; but it is not so absurd as it may appear to many at first sight. If this view of the law was carried out in practice in all respects,—that is, if a bank could keep the amount of its loan at double the amount of its capital, and at the same time hold an amount of specie equal to the capital, the profit to the bank, and the accommodation to the public, would be greater than they are now, under the existing practice and management. Neither could it be said, in that case, that the large amount of specie was lying idle in the vaults of the bank, while it was thus quietly sustaining an amount of credit, in the shape of circulation and deposits, that enabled the bank to loan out, on interest, double the amount of the capital; each dollar of the capital thus held in coin would, under these circumstances, be performing for the community, and for the bank, the legitimate duty of two dollars. The specie would be quietly performing a useful service to our own community, instead of being exported, as it is now under our system of bank management, to pay for imports of articles produced by foreign labor, which take the place of products of our own manufacture. To hold an amount of specie equal to the capital of the banks, may seem to be extravagant, and disastrous to commerce, to those who are accustomed to conduct banking upon a small proportionate amount of specie, as has been usual in this country. But the amount of specie in the Bank of England usually exceeds the amount of the capital, and in the Bank of France it is generally far in excess of the capital,—often more than double the amount of the capital. It is these vast

amounts of specie, as they appear to be to us, that give to the banks of England and of France the ability to sustain with safety an amount of liabilities, and to furnish to the people and to the governments of those countries, an amount of loans, so much beyond what our banks can do.

To retain our specie at home, and in the banks, would not deprive the country of foreign commerce, or of articles, of use and luxury, of foreign growth or manufacture. These would be imported still, and paid for by the export of articles of our own growth and manufacture; and this is the best way, and ought to be the only way, of paying for foreign goods and foreign luxuries. Foreign commerce would then be a fair exchange of the products of our own labor for the products of foreign labor, which would be a mutual advantage. In that way the foreign trade of the country would be made to encourage and foster domestic industry as it ought, instead of being, as much of it is now, to a great extent, antagonistic to home industry. It will be soon enough to consider specie as a product of labor merely, when the supply of it has accumulated beyond the wants of the country. Then the excess can be exchanged, with advantage to the community, for articles of the growth and manufacture of other countries. But until there is an excess of specie in our country beyond what can be made useful and convenient, and the substantial wealth of the whole country is at least equal to that of Great Britain or of France, the specie should be retained at home; and the demand for the products of our soil and of our manufacture should be encouraged by their use for export, to furnish the means to pay for the import of foreign products.

Wise and prudent statesmanship has always encouraged home industry by promoting in every way the demand for its products. An unskilful and ignorant population are dependent on foreign trade for many conveniences and luxuries which they have not the skill to produce, and their own labor is confined to the ruder and less profitable employments, keeping them comparatively poor and dependent. The prosperity and wealth of England and of France are mainly to be attributed to the skill that has been developed by the constant investments of their accumulated wealth in the industrial pursuits of those countries, both agricultural and manufacturing. These investments have stimulated science and invention, and kept their population actively employed. Whether the laborer has always received his fair proportion of the results of his labor, is another question. It has not been deemed beneath the dignity of their greatest statesmen to observe and study the course of the business of the community, and particularly to watch the commerce and exchanges with other countries, to prevent the drain of coin from the country, and to be certain that the imports from abroad are paid for by the export of the products of the labor of the country. History has awarded the highest honors to those statesmen who have developed and promoted the general prosperity and wealth of their country by devising systems and measures to give the greatest encouragement and employment to the labor and industry of the people.

When the discounts of the banks in any place are judiciously made to business people, to be used by them for the daily regular purposes of their business, they do not usually create any immediate demand for specie,

except between those banks, in their settlements with each other. It is only when any part of the money is to be taken away to a distance, where the bills of these banks would not circulate, or when it has been paid into other banks, that specie will be demanded. The amount of circulation and of deposits required by the community will depend on the extent and activity of its business; and, on the other hand, the extent of the business of the community, and its activity, are greatly influenced and encouraged by the extent of the "accommodations" that the banks can furnish to the merchants and traders. Competition among the banks will induce them to furnish the largest amount of "accommodations" in their power; and the only limit to the amount, under a system of prudent management, is the law which restricts the loans of the banks to double the amount of their capital. But to sustain that amount of loans with safety to themselves, they must have the requisite amount of specie. The frequent troubles that occur are the result of unwise attempts on the part of banks to conduct their business with the least possible amount of specie; and this the Louisiana law effectually guards against by requiring each bank in that State to have an amount of specie equal to, at least, one third of the liabilities of the bank.

The credits of the banks, in the forms of deposits and of circulation, may be said to constitute the medium, or currency, for all the business transactions of the United States east of the Rocky Mountains; for, except the fractional coins, which are used for the smaller retail transactions of purchases and sales below the value of one dollar, and for "change," there is no other currency

in general use by the people for the trade and commerce of the country. There is undoubtedly a very considerable amount of coin in the country beyond what is in the banks, but it is generally hoarded or laid by to meet emergencies, and does not form a part of the circulation in daily use for the purposes of trade, like the bank-note circulation and the bank-deposits; at least, in the Northern States of the Union the amount of coin in circulation is too small to be considered. The payments in all the larger transactions of trade are made by bank-checks, which transfer portions of deposit in banks from one party to another; in the smaller transactions, the payments are made in bank-notes.

The amount of bank credits in use, as circulation and deposits, for the transaction of the business of the community throughout the United States, estimated from the fullest information that could be procured by the Treasury Department in Washington, for the annual "Report on Finances" of the Secretary of the Treasury, was,

For the year 1857.	Circulation, . . .	\$214,778,822
	Deposits, . . .	230,351,352
Specie in the banks, \$58,349,838	Total of bank credits,	\$445,130,174
For the year 1858.	Circulation, . . .	155,208,344
	Deposits, . . .	185,932,049
Specie in the banks, \$74,412,832	Total of bank credits,	\$341,140,393

It thus appears, that in the year 1857, there was one dollar of specie in banks to sustain about  $\$7\frac{62}{100}$  of bank credits; and in 1858, there was one dollar in specie to  $\$4\frac{58}{100}$  of bank credits. It certainly cannot be said that the \$58,000,000 of coin, in the banks in 1857, was lying idle, while it was used in the vain attempt to sus-

tain more than seven and a half times its amount of bank credits, on which the merchants and traders relied to conduct the trade and commerce of the country. But it is, perhaps, equally surprising to notice in the statements the difference, at the two periods, in the total amounts of this medium furnished by the banks for the transaction of the business of the country. The reduction of over one hundred millions of dollars, equal to nearly one quarter of the whole, within a single year, would seem to account sufficiently for all the financial disaster and depression in business that have occurred in the United States since the summer of 1857. Over one hundred millions of capital was withdrawn from the use of the community within one year, and probably within the space of a few months; not withdrawn from particular branches of industry to be employed in other ways, but absolutely annihilated because of the insufficiency of the specie in the banks.

The banks are permitted, both by law and by custom, to furnish all the currency, or medium, that is needed for the transaction of the trade of the country, on the condition that it shall at all times, when required, be converted into coin. With prudent management, this requirement, except for moderate amounts, would be rarely made; but this is because the ability to convert it is believed to exist. The ability of the banks to furnish this currency depends on the public faith in their ability to redeem it if demanded; and to insure that ability, there should always be an amount of specie in their vaults proportioned to the amount of their liabilities. The failure of their ability has always been caused by the disposition on the part of banks to hold the smallest possible reserves in coin. When they have perceived

that a given amount of specie was sustaining five times or more of its amount in bank credits, instead of retaining that amount of specie, or increasing it, to enable them to add to the amount of their credits, the banks, regardless of past experience, have sought to sustain the existing amount of credits with a less proportion of specie, and have constantly diminished the amount of it, or have increased their liabilities, so as to diminish the proportion of specie to the liabilities, until the whole fabric of credit, which has been created upon faith in their prudent management, totters and breaks down, involving the banks and the community in all the evils of a suspension of specie payments. The banks have gradually recovered themselves, without much loss; but thousands of families have been suddenly reduced from prosperity to irretrievable poverty. Yet legislation now permits the banks to go on as before, to repeat the catastrophe after an interval of a few years.

To refer again to the "Report on Finances" of the Secretary of the Treasury; it appears, according to the returns reported there, that the banks of the State of New York held —

In 1855, \$10,910,330 of specie,	against	Circulation, \$31,340,003
		Deposits, 88,852,395
or, one dollar of specie to about \$11 of bank credits.		Total, \$120,192,398
In 1856, \$12,898,771 of specie,	against	Circulation, \$34,019,633
		Deposits, 96,907,970
or, one dollar of specie to about $10\frac{7}{10}$ of bank credits.		Total, \$130,927,603

#### The banks of Louisiana held —

In 1855, \$8,191,625 of specie,	against	Circulation, \$7,222,614
		Deposits, 14,747,470
or, one dollar of specie to about $2\frac{7}{10}$ of bank credits.		Total, \$21,970,084

In 1856, \$6,811,162 of specie,	against	Circulation,	\$9,194,139
		Deposits,	13,478,729
			<hr/>
or, one dollar of specie to about $3\frac{3}{10}$ of bank credits.	Total,	\$22,672,868	

Under these very different conditions of the banks in the States of New York and Louisiana, it is not surprising that the financial crisis of 1857 caused the New York banks to suspend specie payments, while the Louisiana banks were able to pass through the crisis without disturbing the currency of that State, and without distressing the business community. To have made the New York banks, relatively, equal in strength of condition to the Louisiana banks, there should have been not less than \$35,000,000 of specie in the New York banks. And they had more than that amount within a year after their resumption of specie payments; but now it has again been reduced below \$20,000,000. That largest amount of coin, instead of costing the New York banks any thing, was brought to them, free of any cost; and it increased their profits, by enabling them to furnish and sustain a larger amount of loans for the accommodation of the merchants and others. It is not, perhaps, venturing too much to say, that, if the New York banks had, for the twelve months preceding the suspension of specie payments, been in the condition, as regards the amount of their specie, that they were in during the subsequent twelve months, the unfortunate interruption of the business of the country which occurred in 1857, with all its consequent distress and ruin to merchants and others, would have been avoided.

It is sometimes said by those who are not familiar with the details of banking, that a bank cannot exercise control over the amount of its specie; as, with a large amount of liabilities out, that are payable on demand, it



is impossible to know from whence, or by whom, or to what extent, a demand for specie may be made. But no intelligent manager of a bank will admit the correctness of this, except to a very limited extent; because the theory of the banking system is, that the amount of specie can be controlled, as far as it is necessary, by prudent management in extending and diminishing the loans of the banks. Were it otherwise, it would be an absurdity to attempt conducting the trade of the country with a medium redeemable in specie, without a reserve of an equal amount of coin that could be applied to that purpose.

It must be borne in mind, that, in addition to the one third in specie required by the law of Louisiana, the banks there hold the other two thirds of their liabilities, and also the amount of their capital, in debts of the merchants and others, which are daily falling due, if their loans have been judiciously made; and that the merchants and others, who usually hold notes and other liabilities of the banks, rely upon them as the means to pay to the banks the amount of their debts as they daily become due. This, without new loans or discounts from the banks, will soon reduce the amount of the outstanding liabilities of the banks to what the public absolutely require in transacting their daily business of buying and selling; and this use for a large amount of the liabilities of the banks will not be relinquished by the community so long as they have confidence in their security. The fundamental idea of a currency of paper-money redeemable on demand in specie is, that the amount necessary to conduct the business of the country will be kept constantly in circulation; and that specie is required by the banks only to redeem any

excess of such currency growing out of the competition among the different banks for the profitable business of supplying it, or to meet any incidental demands that may occur from individual wants for specie for some specific purpose.

The amount of currency required by the community is constantly varying, in consequence of the constantly varying condition of its business, which influences the amount of currency that can be advantageously used; and this varying condition of business is always influenced, and sometimes controlled, by the amount of this currency that the banks are able to furnish with convenience. It is only the excess beyond what is absolutely necessary to the community for the ordinary and multifarious and daily purposes for which money is used, that will be returned to the banks to be redeemed in specie, so long as there is confidence in their security. Unless the loans of the banks have been extended altogether beyond the bounds of prudence, the amount of one third of their liabilities in specie should always be abundantly sufficient to meet any demands for specie from that excess, and, at the same time, sufficient to preserve the confidence of the public in the ability of the banks to meet promptly any demands that can be made upon them.

The foundation of the credit of the banks is the unwavering confidence of the public in their ability to meet their engagements in specie. Public law and popular opinion should combine to prescribe as an absolute rule for banks, that they shall keep an amount of specie sufficient to insure the convertibility of their notes in circulation, and of their deposits, at all times, and under all circumstances. Whenever a

crisis has arisen heretofore, this has not been the case, and the banks have been compelled, for the want of specie, to contract their loans, in a vain struggle, as it has proved, to redeem their promises. They are powerless to aid their debtors at such times, and force them into insolvency by annihilating the means which they had before furnished to sustain prices, and to conduct the business of the country. The financial history of the United States has consequently been, in a great measure, "a history of extravagant expansion, followed by ruinous contractions."

The good credit of the banks is the source of their profits ; and so long as bank credits are used as the medium for the trade of the country, the public prosperity is also dependent upon their good credit. It seems, therefore, just and right that the law should interfere, as it does in the State of Louisiana, and as it does, to a limited extent, in Massachusetts, to oblige every bank to hold the amount of specie that will secure its ability to meet its engagement to pay all demands promptly in specie.

An intelligent English writer, whose experience and position give great weight to his opinions on financial subjects,\* says: "The main advantage of paper-money lies not in the increased capital which it places, or seems to place, at our command, but in the greater facility with which it enables us to effect the payment and receipt of large amounts. The facility would be none the less, if five sovereigns or five thousand sovereigns had been locked up for every equivalent bank-note

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\* Mr. Latham, Deputy-Governor of the Bank of England.

issued. It is true, that an issue on these terms would be a public loss, or rather a public cost, of some two or three hundred thousand pounds a year, being about the equivalent of the tax upon dogs, or of a single farthing in the pound of income tax, or of two days' expenditure in the recent war. Still, considering that it would effectually silence all the clamor that we hear about the management or mismanagement of the currency, that of itself would be no slight setoff." "If there were no Bank of England, or no banks at all, no gold, and no silver,—for these are mere ripples on the surface,—the great stream of interchange might still roll on, the same relations between borrower and lender might still exist, and the issue of their transactions be not very different from what it is under the present artificial and greatly overrated arrangements."

The banks of the city of New York, considered as a unit, sustain, by their position as the banking institutions of the great commercial metropolis of the country, relations towards the commerce and the financial operations of the United States, in their aggregate power, similar to those of the Bank of England and the Bank of France in their respective countries. The capital of the New York City banks is nearly the same as the capital of the Bank of England, and very much more than the capital of the Bank of France. And, as in those institutions, the bank-vaults in the city of New York should be the great depositories of the specie reserves upon which the bank credit of the country depends.\* In such great commercial cities, the com-

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\* Capital of the New York City banks, \$68,933,632; of the Bank of England, £14,553,000; of the Bank of France, 182,500,000 francs.

mercial and financial operations of countries concentrate, and therefore their bank-notes and their bank credits should be equivalent to specie in all other parts of the country. It is so throughout France, in regard to the notes or the credits of the Bank of France; and throughout Great Britain, in regard to the notes or credits of the Bank of England; — not because their notes are made a “legal tender” at other places than the bank, but because their usual reserves of specie are large, and sufficient to create entire confidence in their ability to meet all the demands that can be made on them. It should be the same, also, throughout the United States, in regard to the notes or credits of the New York City banks; and it will be so when their reserves of specie, like those of the banks of England and of France, are sufficiently large to secure their ability at all times, and under all circumstances, to meet their engagements to pay in specie; and this confidence of the public will be a great source of profit to the New York banks, and of incalculable value to the commerce of the country. But it is out of the question for the banks of the city of New York to hold that relation of entire confidence through the country, so long as the action of each bank, in regard to the amount of its reserve of specie, is dependent upon the peculiar views or character of its board of managers. The *law* must secure the uniform ability of the banks to meet their engagements by making it imperative upon each one of them to hold the requisite amount of specie as a condition of their power to discount.

Every district of country has its metropolis, or central point, to which the trade and monetary affairs of

that district concentrate, and in which the bank-notes in use for currency through the district, whether they are the notes issued by the banks of the city or out of the city, are mostly redeemed. Boston is that metropolis to Massachusetts, and to the greater part of New England ; Philadelphia is so to Pennsylvania ; and New Orleans is so to Louisiana, and to parts of the surrounding States. In like manner, the city of New York, in addition to being the metropolis, or commercial monetary centre, of the State of New York, is also the great commercial metropolis of the whole of the United States. It is the point, or place, upon which a bill of exchange, in any other part of the United States, is of most value.

It is because the notes issued by the banks in Massachusetts, "*out of Boston*," are mostly redeemed in the city of Boston, that the law which requires the banks to keep fifteen per cent. of their liabilities in specie, provides, that balances, *not bearing interest*, due from the banks in the city of Boston to the banks "*out of Boston*," shall be considered as equivalent to specie in the banks "*out of Boston*" for the purposes of the law. The effect of this law to the country banks, or banks "*out of Boston*," is analogous to, but more convenient than, that of the English law, which makes the notes of the Bank of England a "*legal tender*" in all parts of Great Britain except at the bank itself. The Bank of England redeems all its liabilities in specie ; but the country banks in Great Britain may redeem their liabilities either in coin, or in the notes of the Bank of England, which will command the coin in London. An amount of specie equal to fifteen per cent. of the liabilities of the country banks would be a useless incum-

brance in their bank-vaults, scattered through the different towns in the country, while their liabilities are redeemed, as they are now, so conveniently to the business of the community, by some bank in Boston acting for that purpose, as the agent of the country banks. The specie is wanted at the place where the liabilities are redeemed. If the liabilities of the Boston banks are made secure by a sufficient amount of specie in their vaults, the balances they owe to the country banks are made secure; and it would be unnecessary, in addition, to require that the country banks should have, over and above their balances in the Boston banks, fifteen per cent. of their liabilities in specie in their own bank-vaults, where it would be useless for the purposes for which specie is required. It is important, however, that the balances, which the law thus considers as in the place of specie in the country banks to be used for the purpose of redeeming their liabilities, should not be on interest, that the Boston banks may be induced to retain a larger proportion of the amount in coin, and not be forced to increase their loans, as would be necessary if interest should be paid to the country banks on the amount of these balances; for they cannot afford to pay any interest, unless they loan them out, and at a higher rate of interest than they pay. The policy of the law should be to discourage the payment of interest on these balances, because it would be prejudicial to the public.\*

The banks of Boston, and of the other great commercial capitals, or metropolitan centres, must hold large reserves of specie, not only for their own uses, but for

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\* See Appendix B.

the benefit of the banks throughout the region of country to which they are the centres ; and they should find compensation for it in the balances which the "country banks" allow to lie with them, not bearing interest, to redeem their circulation. The banks of the city of New York (that city being the great metropolis of the whole country) should set the example in regard to specie. When the New York City banks are by law obliged to keep in their vaults an amount of specie equal to one half, or, at least, to one third of their liabilities for circulation and deposits (and not until then), they will command unlimited confidence throughout the United States ; and the banks throughout the State of New York, and in all the large cities throughout the United States, will consider that balances due to them from New York City banks are equivalent to, and will command, specie. The liabilities of the New York City banks, since 1857, have never been less than eighty millions, or more than one hundred millions ; and therefore, under such a law, from thirty to fifty millions of specie in their vaults would be required. More than sufficient specie for this purpose will arrive at New York within a few months ; and the question for the banks there will be simply, whether it shall be retained, or whether it shall be shipped away as a tribute from our folly to the wiser systems and laws of banking in England and in France. This large requirement of specie may seem an absurdity to many who have become familiar with the usual poverty of specie in the New York banks ; but it will not appear so to many intelligent men, both in this country and in Europe, to whom, heretofore, boasts about the strength of the New York City banks, when they had ten dol-



lars or more of liabilities to one of specie, have seemed not only absurd, but lamentable. The vastly improved condition of the trade and commerce and finances of the country, which would result from such a requirement, would soon insure for the law the entire approval of intelligent men both at home and abroad.

What would be thought of the condition of the Bank of England, or of the Bank of France, if either held only one dollar of specie in its vaults to ten, or even five, dollars of immediate liabilities? In regard to the Bank of England, with about the same amount of capital as the banks of the city of New York, the reduction of their specie below £10,000,000 is considered almost a public calamity, and, whenever it occurs, the commerce of the whole world is affected by it. There are usually from fifteen to twenty million pounds sterling in specie in the vaults of the Bank of England, the equivalent of seventy-two to ninety-six millions of dollars. This, together with the coin in general circulation (no bank-notes being issued of a denomination below £5), forms the great reserve of specie on which is based the immense fabric of English bank-credit, extending more or less through the world of commerce.

When the banks of the city of New York, the commercial metropolis of the United States, are compelled by law to keep an amount of specie approximating to that of the Bank of England, the intelligent portion of the commercial world will begin to feel a confidence in the currency of the United States which has never existed hitherto. Notwithstanding that the amount of specie in the Bank of England is usually more than the whole capital of the bank, and so far beyond the aggregate of specie in the New York banks, yet that bank has a cor-

respondingly large amount of loans and securities upon which interest is received, and by which large dividends are earned for the stockholders of the bank. The Bank of France likewise, frequently holds more than double the amount of its capital in specie, with similar results to the nation and to the stockholders of the bank.

The first notice to the public of a decline of the specie in the Bank of England is "a rising rate of discount, leading to a reduction in the price of interest-paying securities, and a difficulty of renewing such loans as may be falling due, unless on terms less favorable to the borrower, and more favorable to the capitalist concerned."\* This is precisely the effect of the curtailment of bank loans in this country; though the bank rate of discount is not usually raised, because it is rarely reduced much below the legal rate of interest. But the "*street*" rates of discount immediately rise, often to a frightful point; and by this process the "exchanges" are soon turned in favor of the banks, and specie comes back again to their vaults.

The reduction of the specie in the Bank of England below £10,000,000 is a rare event, usually caused by some great calamity, such as the breaking out of war, or a deficient harvest, or some extraordinary excitement of speculation, which produces a drain of specie from the country. But the Bank of England, in ordinary times, holds an amount of specie that, for forty years past, has enabled it to meet such extraordinary demands. This bank is able to hold so large an amount of specie by pursuing the policy at all times of keeping the "exchanges" with other countries in favor of Eng-

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\* Letter to the editor of the Times, by Mr. Latham.

land, and of discouraging any disposition or tendency to export specie. However a drain of specie may originate, the fact of its existence shows conclusively that specie is more valuable abroad, and consequently that the currency is redundant and ought to be diminished. The Bank of England and the press of Great Britain never consider or represent specie to be a mere product of labor to be exported, nor the abundance of specie in the bank-vaults as an incumbrance to be rid of, as was represented in regard to the condition of the New York banks, through the summer of 1859, by the press of that city; which boasted of the export from New York to England of six or eight millions of coin in a single week, as evidence of the wisdom and greatness of New York,—instead of which it was, in the estimation of many, proof of the recklessness and folly of the management of the New York banks.

And now, in view of the facts and statistics herein recorded, and the theories herein suggested, it is believed that, if the different States of the Union would enact laws, by which all the banking institutions of the United States should be controlled in their relations to the business of this country, as the Bank of England and the Bank of France are in relation to those countries respectively, property, and all the industrial interests of the United States, would be rendered more secure, and the general welfare of the people would be much better subserved, than they are by the irresponsible and disjointed system of banking now encouraged by the different States of the Union. The laws of Louisiana, and of Massachusetts, so often referred to in these pages, are steps towards a result so much to be desired.

If what has been written shall lead to convictions in other minds, that may have influence to confirm Massachusetts in the course commenced by the law of 1858, and to induce her and the other States to follow the example of the State of Louisiana, whose legal requirement of specie in the banks is ample to secure a good currency, benefits must result that will be felt by the community in every pursuit and in every condition of life.



## APPENDIX.

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### A.

THE following is the substance of the reply to a letter addressed to a very intelligent gentleman in New Orleans, thoroughly versed in all matters of finance. The writer of the letter, asking him for a more recent statement of the condition of the banks of that city, desired to know, among other things, if interest is ever allowed on any of their deposits, and if there are any sources of profit to the banks in New Orleans that are not common to banks in Boston and New York.

NEW ORLEANS, December 13th, 1859.

MY DEAR SIR,

\* \* \* \*

Whatever the state of the money market may be, here or elsewhere, six per cent. has been the invariable rate at the banks for discounting commercial paper maturing within ninety days; and, at this rate, the banks are always ready to discount the sound paper of their customers. This is the only inducement they offer to leave deposits with them, and they never pay any interest on deposits, like the New York banks. Allow me to quote from a letter which I have recently written, in reply to certain questions propounded to me from a western legislative committee, as it answers some of your inquiries.

“The complaint of a want of capital throughout the Western States, I consider as groundless. If confidence existed, there would be abundance of capital for all legitimate purposes. So long as you permit the circulation of paper-money, redeemable at distant points, to evade the payment of specie, gold will be at a premium with you; and so long as gold is at a premium in your great commercial centres, it will be in vain to look for confidence in your currency, and capital will not show itself where there is no confidence. In this State, where the banks are not permitted to use any other paper-money than their own

respective issues, and the circulation of the paper-money of other States is prohibited, gold is at par, and it is as common in the hands of the public, for circulation, as paper-money. This, together with our law, which requires the banks to hold an amount of specie equal to one third of their liabilities, produces a degree of confidence which adds greatly to the working capital. The banks in the city of Boston, for example, with capital paid in amounting to \$38,162,600, by official report dated 20th September last, held \$5,342,000 in coin, and had under discount and in various securities \$58,856,500. The report of the banks of New Orleans, with \$24,476,516 of capital, exhibits \$54,390,930 under discount and in securities, and at the same time they held \$15,572,505 in gold; in proportion to capital, therefore, the banks of New Orleans had \$9,525,146 more of loans, or of real working capital, with nearly three times as much gold in their vaults, as the banks of Boston. This is the result of confidence in our system of banking; and hence the large profits which enable our banks to pay ten to fifteen per cent. annually in dividends to the stockholders, besides large reserves of profits; and to this also they were indebted for the enviable position which they held, with but a passing cloud, during the crisis of 1857."

I send you the weekly statement of the banks published in our newspapers, which contains the exhibit of the cash and of assets payable within ninety days, and the liabilities, to show if the banks are in rule or not. Also the Board of Currency report, made up on the last Saturday of every month, which embraces both the "movement" and the "dead weight," and is a complete exhibit of the position of our banks. You will perceive, that on the 26th of November, the total amount of assets was

From which deduct the amount of gold on hand,	\$60,563,794
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	12,438,190
Gives the amount of loans and securities bearing interest,	<u>\$48,125,604</u>

On a capital paid in of	\$24,496,866
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The sources of the profits of our banks are enumerated under their proper heads in the report of the Board of Currency, to wit:

Loans discounted at six per cent. payable in full at maturity within 90 days.

Foreign and domestic exchange.

City and State stock bearing six per cent. interest; chiefly held by the "Free Banks" to guarantee their circulation.

Long loans and stock loans over 90 days, on interest, or discounted at the rate of  $6\frac{1}{2}$  to 8 per cent.

Before the crisis in 1857, the "Canal Bank" and the "Bank of Louisiana" dealt in foreign exchanges, but only to a moderate amount. For the last two years that business has been left mostly to private competition.

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B.

THE LAW OF MASSACHUSETTS PASSED IN 1858, REQUIRING THE BANKS TO HOLD FIFTEEN PER CENT. OF THEIR LIABILITIES IN SPECIE.

AN ACT to increase the amount of Specie in the Commonwealth.

*Be it enacted, &c., as follows:*

SECT. 1. Every bank within this Commonwealth shall be required to keep an amount of specie equal to fifteen per centum of its aggregate liability for circulation and deposits; and whenever, by the weekly or monthly returns required by the three hundred and seventh chapter of the acts of the year eighteen hundred and fifty-four, the weekly average amount of specie in any bank in Boston is less than fifteen per centum of the aggregate liability of said bank for circulation and deposits, or, in any bank out of Boston, or any bank in South Boston redeeming its bills at any other bank, the monthly average amount of specie is less than fifteen per centum of the aggregate liability of said bank for circulation and deposits, it shall be unlawful for any such bank to make new loans or discounts, until the amount of specie in said bank shall be restored to the proportion of fifteen per centum of its aggregate liability for circulation and deposits: *provided*, that banks out of Boston, in the monthly returns required by the three hundred and seventh chapter of the acts of the year eighteen hundred and fifty-four, shall return the monthly average amount of balances in other banks, not bearing interest, which may be applied to the redemption of their bills, and the same shall be considered and deemed as equivalent to specie for the purposes of this act.















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